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States that use debit cards to distribute government benefits would be exempt from new limits on debit "swipe fees" as part of an agreement reached by key negotiators of the financial regulatory reform bill, Sen. Dick Durbin, D-Ill., announced Monday.

The agreement among Durbin, House Financial Services Chairman Barney Frank, D-Mass., Senate Banking Committee Chairman Chris Dodd, D-Conn., and other key lawmakers makes minor, clarifying changes to a measure Durbin authored limiting "interchange" fees that banks charge merchants every time consumers use a debit card, according to Durbin's office.

"We've exempted states from interchange regulations and have included protections to ensure those who can least afford it are protected from unnecessary fees," Durbin said.

The agreement -- exempting federal, state and local government prepaid cards from interchange regulation -- responds to state governments' concerns that the Durbin provision would undermine their ability to disburse government benefits, such as unemployment insurance and child support. Forty-six states and the District of Columbia distribute benefits using prepaid debit card programs.

Nebraska Treasurer Shane Osborn, in a letter to key lawmakers last month, wrote that regulating interchange would diminish financial institutions' revenue and their ability to offer cost-effective programs to the public sector.

After Monday's announcement, Trish Wexler, a spokeswoman for the Electronic Payments Coalition, said the compromise provides a "short-term Band-Aid" for states.

"If you come in and destroy the economics of a market, ultimately the market is going to shrink and fail everybody involved," said Wexler, whose group represents card issuers and networks.

Negotiators of the financial reform bill are expected to approve the new language as part of the final bill, according to Durbin's office. The House and Senate must pass the final legislation before it becomes law.

Rep. Peter Welch, D-Vt., a leader in swipe-fee reform efforts, called the agreement a "major victory for small-business owners and consumers."

"It preserves key protections for the grocers, retailers and country store owners most affected by out-of-control swipe fees, while addressing legitimate concerns of the industry," he said.

The National Association of Convenience Stores "strongly supports" the compromise, said Lyle Beckwith, a NACS spokesman, as does the Merchants Payments Coalition.

Durbin's amendment passed the Senate on May 13 on a 64-33 vote. The amendment would direct the Federal Reserve to make sure swipe fees for debit cards are "reasonable and proportional" to processing fees.

It would also prevent credit card companies such as Visa and MasterCard from penalizing merchants that offer customers discounts for using other forms of payment with lower or no fees. The provision would also let merchants decline credit cards for small purchases of \$10 or less.

It would exempt banks and credit unions with assets under \$10 billion from the limit on debit card swipe fees.

Vermont recently became the first state to limit swipe fees on both debit and credit cards. The state also prevents credit card networks from fining merchants that set a minimum for credit card purchases or offer discounts to customers using cards with smaller fees.

